FILE COPY

NOV
CHARLES

Supreme Court of the United States

OCTOBER TERM, ————.

Nos. 300 and 301.

SOUTHERN RAILWAY COMPANY, - - - Appellant,

versus

COMMONWEALTH OF KENTUCKY, By, &c., - - Appellee.

ANDREW W. MELLON, Director General of Railroads, - - - - - - - - Appellant,

versus

COMMONWEALTH OF KENTUCKY, By, &c., - Appellee.

BRIEF FOR APPELLANTS.

L. E. JEFFRIES,
S. R. PRINCE,
EDWARD P. HUMPHREY,
CHARLES W. MILNER,
Louisville, Kentucky,
Counsel for Appellants.

WESTERFIELD-BONTE COMPANY, INCORPORATED, LOUISVILLE, KY.

SUBJECT INDEX.

PAGE

1. Statement 2

2. This is the second appeal of these two cases. The suit is to recover alleged omitted franchise taxes. On the first appeal this Court reversed the judgment of the State Court on constitutional grounds 2

   Southern Ry. Co. v. Kentucky, 274 U. S. 76.

3. With no new fact in the record, the State Court has affirmed the identical judgment that was reversed by this Court 2

4. Extracts from prior opinion of this Court stating facts of case, legal principles involved, and decision of Court 4

5. The prior opinion of this Court holds that under Kentucky Statutes, a railroad company's "system" includes lines owned, operated, leased and controlled, and that in calculating the franchise tax, figures of all owned, operated, leased and controlled roads must be included 12

6. The opinion also states that appellant's "control" of the Cincinnati, New Orleans and Texas Pacific Railway Company was in the record at that time by stipulation 7

7. Since, therefore, appellant's "control" of the Cincinnati, New Orleans and Texas Pacific Railway Company was in the record on the first appeal to this Court and since figures of all controlled roads must, under Kentucky Statutes, be used in calculating appellant's franchise tax, any claim of the Commonwealth on account of such Cincinnati,

PAGES

New Orleans and Texas Pacific Railway Company control was necessarily in the record and before the Court. 13

8. By stipulation filed after the reversal by this Court, it is stipulated that in the calculation used to make up the reversed judgment, all figures of the Cincinnati, New Orleans and Texas Pacific Railway Company were included. 13

9. On the prior appeal, it was shown that the result of operations of the Southern Railway Company in Kentucky (which the State Court had held was but a division of the appellant) was a net average loss of $1,230 per mile per year; that the average income of appellant's "system" was slightly more than $3,600 per mile per year; that the net income of the Cincinnati, New Orleans and Texas Pacific Railway Company was more than $14,000 per mile for the first year and more than $9,000 per mile for the second year, and that the Cincinnati, New Orleans and Texas Pacific Railway Company had paid franchise taxes on such income, therefore, the Cincinnati, New Orleans and Texas Pacific Railway Company had paid taxes on values largely in excess of the system average. 17, 18

10. Appellee's petition for rehearing in this Court, after the opinion of this Court, states repeatedly and unequivocally that the Commonwealth "did claim taxes growing out of the Cincinnati, New Orleans and Texas Pacific Railway Company operation and ownership" by appellant; that "the facts essential to make out this state of affairs" and "the stock control" were in the record by pleading and stipulation 20

11. Since the facts of control and figures were in the prior record by stipulation, the reversal by this

PAGES

Court was not because of any defect of pleading, but was solely on the merits of the case..... 22

12. Stipulated facts take the place of both pleading and proof.....22, 23

Saltonstall v. Russell, 152 U. S. 628.
Lincoln County Bd. of Education v. Bd. of Trustees, 225 Ky. 21.

13. After the reversal by this Court the Commonwealth filed an amended statement "for the purpose of making claim for taxes against the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company." This was later amended by substituting the words "in respect of" for the word "against"..... 25

14. Argument..... 35

15. The Kentucky Court of Appeals erroneously assumed that the above amendment making a claim for taxes against (or in respect of) the Cincinnati, New Orleans and Texas Pacific Railway Company constituted a new fact in the record and affirmed a judgment identical in amount, identical in figures and basis of calculation with the judgment that was reversed by this Court..... 35

16. The claim for taxes in respect of the Cincinnati, New Orleans and Texas Pacific Railway Company control by appellant was not a new fact because, as stated by the Commonwealth in its petition for rehearing, the facts showing such control and the figures were stipulated in the prior record.

The facts with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were actually included in the calculation of the reversed judgment. In addition, as stated by this

PAGE

Court in its first opinion, the figures of controlled roads are required to be included in a franchise tax calculation. Therefore, no pleading was necessary to bring in a controlled road 36

17. The answer filed affer the amended petition raised all constitutional questions 27

18. The Court of Appeals of Kentucky considered such constitutional questions and decided them adversely to appellants 29

19. The judgment of the State Court is erroneous in that it spreads over mileage of the Cincinnati, New Orleans and Texas Pacific Railway Company the alleged franchise valuation which can be assigned to the mileage of the Southern Railway Company in Kentucky alone 41

20. The judgment is further erroneous in that it is against both the Southern Railway Company and the Director General of Railroads. During the years involved the railroad was in the hands of and being operated by the United States Government. The franchise tax is a property tax, *i. e.*, a property tax on the intangible property of a corporation. The Director General alone is responsible for the property taxes of the railroads during Federal control 42

U. S. Comp. Stats. Anna. Supp. 1919-1923, Sec. 3115¾, *et seq.*

Davis, Director General, v. Dantzler Lbr. Co., 261 U. S. 280.

North Carolina R. R. Co. v. Lee's Admrx., 260 U. S. 16.

Henderson Bridge Co. v. Commonwealth, 99 Ky. 623.

PAGE

21. The judgment is also erroneous in imposing a penalty of twenty per cent against the Director General 44

Kentucky Statutes, Sec. 4241.
Missouri Pacific v. Ault, 266 U. S. 554.
Norfolk Southern Ry. Co. v. Owens, 256 U. S. 565.

ALPHABETICAL LIST OF CASES.

	PAGES
Commonwealth v. L. & N., 149 Ky. 829	14
Davis, Director General, v. Dantzler Lbr. Co., 261 U. S. 280	44
Greene v. Louisville & Int. R. R. Co., 244 U. S. 499	42
Henderson Bridge Co. v. Commonwealth, 99 Ky. 623	42
Kentucky Statutes, Sections 4077-4091	31
Kentucky Statutes, Section 4241	45
Lincoln County Bd. of Education v. Bd. of Trustees, 225 Ky. 21-24	23
L. & N. R. R. Co. v. Greene, 244 U. S. 522	14
Missouri Pacific v. Ault, 266 U. S. 554	45
Norfolk Southern Ry. Co. v. Owens, 256 U. S. 565	46
North Carolina R. R. Co. v. Lee's Admx., 260 U. S. 16	44
Saltonstall v. Russell, 152 U. S. 628	22
Southern Ry. Co. v. Kentucky, 274 U. S. 76	2, 3, 4, 12, 17, 18, 19, 22, 27, 39
Southern Ry. Co. v. Commonwealth of Kentucky, 193 Ky. 474	4
Southern Railway Co. v. Commonwealth of Kentucky, 204 Ky. 388	4, 16
Southern Ry. Co. v. Comm. of Ky., 238 Ky. 638	1, 2, 35, 38, 40, 45
U. S. Comp. Stats., Anno. Supp. 1919-1923, Sec. 3115¾, *et seq.*	43

Supreme Court of the United States

OCTOBER TERM, ————.

Nos. 300 and 301.

SOUTHERN RAILWAY COMPANY, - - - *Appellant,*

v.

COMMONWEALTH OF KENTUCKY, BY, &C., - *Appellee.*

ANDREW W. MELLON, DIRECTOR GENERAL OF RAILROADS, - - - - - - - *Appellant,*

v.

COMMONWEALTH OF KENTUCKY, BY, &C., - *Appellee.*

BRIEF FOR APPELLANTS.

The opinion of the Court below is reported in 238 Ky. 638.

The appellants have heretofore filed brief on jurisdiction and alternative petition for writ of certiorari. These matters will not be again discussed in this brief.

STATEMENT.

This is the second appeal of this case. The prior opinion of this Court is reported in 274 U. S. 76. For the convenience of the Court a copy of the opinion is filed as an appendix to this brief.

The suit was by the Commonwealth of Kentucky to recover alleged omitted franchise taxes from the appellant, Southern Railway Company (a Virginia corporation), and from the Director General of Railroads for the years 1918 and 1919. The Kentucky Court of Appeals in 204 Ky. 388 affirmed a judgment fixing the value of the omitted part of such franchise at $1,730,090.02 for 1918, and at $3,028,592.62 for 1919. On appeal this Court reversed that judgment because the amounts were arbitrarily excessive and included values beyond the limits of Kentucky and were therefore violative of the Fourteenth Amendment (274 U. S. 76).

The present appeal is from a decision of the Kentucky Court of Appeals (R. 290), (238 Ky. 638), which affirms a judgment fixing the value of appellant's omitted franchise for 1918 at $1,730,090.02, and for 1919 at $3,028,592.62.

The Kentucky Court of Appeals has therefore affirmed a judgment which is identical in amount with the judgment that was reversed by this Court. No new fact appears in the present record that would justify this utter disregard of the prior opinion of this Court.

Not only is the present judgment identical in amount, but it is also identical in method, basis of calculation, and identical in every other respect with the

judgment that was reversed in 274 U. S. A comparison of the figures used to make up the prior judgment (Stipulation 3, R. 270) with the figures used to make up the present judgment (R. 279) will show that the figures, method and basis of calculation in the present judgment is a verbatim copy of the figures, method and basis of calculation in the reversed judgment.

On the prior appeal, the calculation used by the State Court in arriving at the alleged omitted value of appellant's franchise was not included in the record, but was furnished this Court in our brief. These figures and the method of calculation were, as stated in the opinion of Justice Brandeis, protested by counsel for the Commonwealth. When the case was returned to the State Circuit Court, counsel for the Commonwealth stipulated (R. 270) the calculation and figures on which the prior judgment was based. This stipulation shows that the figures and calculations used in the reversed judgment are the exact figures and calculations which we furnished the Court in our brief on the first appeal.

The figures and calculations used by the Court in arriving at the present judgment are included in the judgment (R. 279). A copy of the stipulation showing the figures and method of calculation used in the prior judgment and an extract from the present judgment showing the figures and method of calculation used in the present appeal are filed as a supplement to this brief. It will be seen that the figures and calculations used in the judgment that was reversed are

similar in each and every respect with the figures and calculation used in the present judgment.

We submit that it is most unusual for a State Court to thus overrule a decision of this Court on a question of constitutional law.

Instead of making our own statement of the facts and questions involved on the first appeal and which are the same as on the present appeal, we adopt in the interest of clarity and brevity the language of this Court in 274 U. S. 76-77:

"A judgment against plaintiffs in error for franchise taxes imposed under the laws of Kentucky in respect of certain lines of railway was affirmed by the highest court of that State. 204 Ky. 388. And see 193 Ky. 474. Reversal is sought on the ground that as applied these laws contravene the due process clause of the Fourteenth Amendment.

"The statutes* (§§4077-4081) provide that every foreign or domestic railway company, in addition to other taxes imposed by law, shall pay an annual tax on its franchise. The provisions apply whether the privilege is exercised by the corporation in its own name or in the name of another which it adopts. A company's railway system is deemed to include lines operated, leased or controlled whether technically owned or not. The tax is on intangible property. Where the railroad is partly within and partly without the State, the value of the intangible property so to be taxed may be deter-

*The provisions are printed in the margin of Louis. & Nash. R. R. Co. v. Greene, 244 U. S. 522, at page 533.

mined substantially as follows: capitalize the net railway operating income of the entire system for the accounting year last ended; assign to Kentucky its mileage proportion of that amount; deduct the assessed value of the tangible property otherwise taxed; and the remainder is the value taken as the basis for the franchise taxes. When the railroad is wholly within the State, the capitalized net, less the assessed value of tangible property on which other taxes are paid, is taken to be the value of intangible property. *Greene* v. *Louis. & Interurban R. R. Co.,* 244 U. S. 499, 510, and cases cited; *Louis. & Nash. R. R. Co.* v. *Greene,* 244 U. S. 522, 539.

"Plaintiff in error, the Southern Railway Company, is a Virginia corporation. The lines of its system of railroads, exclusive of the Kentucky mileage in question, exceed 9,500 miles and extend from Washington, D. C., into Virginia, the Carolinas, Tennessee, Georgia, Florida, Alabama and Mississippi. The company also has a line from New Albany, Indiana, to East Saint Louis, Illinois. It does not own any railroad in Kentucky. The 'Southern Railway Company in Kentucky' owns 127.63 miles, all of which are in that State. Its branches connect with the line of the Cincinnati, New Orleans and Texas Pacific Railway Company which extends from Cincinnati to Chattanooga and connects it with the system. Its stock is owned by the Virginia company. The same persons are officers of both. The lines of the Kentucky company are reported to public authorities and are advertised as a part of the system. The Mobile and Ohio Railroad Company, the

Cumberland Railroad Company and the Cumberland Railway Company own, in all, about 53.3 miles of railroad in Kentucky, but their lines are not connected with the lines of the Southern Railway Company in Kentucky. The Virginia company through stock ownership controls these companies; but they and the Southern Railway in Kentucky, in their own names and as owners, made reports and paid in full all taxes assessed under Kentucky laws on their tangible and intangible properties.

"The Commonwealth brought this suit against the Virginia company and the Director General to recover additional franchise or intangible property taxes for 1918 and 1919 in respect of the Kentucky mileage of these companies. The Court of Appeals held that there was no such connection or unity of use between the system of the Virginia company and the lines of the Mobile and Ohio, the Cumberland Railroad and the Cumberland Railway as would justify recovery of any franchise taxes in respect of their Kentucky mileage. Stipulated facts tended to show that the Virginia company controlled the Cincinnati, New Orleans and Texas Pacific; and the court held that by means of its lines the railroad of the Southern Railway in Kentucky was so connected with the lines of the Virginia company as to be a part of the system. The value of intangible property adjudged to have been omitted, and on which the additional franchise taxes were calculated for 1918 was $1,730,090.02 and for 1919 was $3,028,592.62. These amounts were arrived at as follows: the net railway

operating income for the entire system was capitalized at seven per cent; there was deducted an amount to cover the value of shops, terminals and double tracks outside Kentucky in excess of corresponding tangible property connected with the lines in that State; there was allocated to Kentucky such proportion of the remainder as 424.61 miles, which were attributed to Kentucky, bore to the total mileage of the system; that amount was equalized for taxation at 75 per cent. for 1918 and at 85 per cent. for 1919; and from the result there was deducted the values of tangible and intangible property (including the Kentucky mileage of the Cincinnati, New Orleans and Texas Pacific) on which taxes had been paid. But the average value per mile so deducted was less than the system average per mile. The amounts so arrived at were assigned to the 127.63 miles of the Southern Railway Company in Kentucky and the 197.5 miles in Kentucky of the lines of the Cincinnati, New Orleans and Texas Pacific. The increase per mile for 1918 was $5,334.55 and for 1919 was $9,338.34.

"The Court of Appeals rightly declared that a State may tax property permanently within its jurisdiction belonging to one domiciled elsewhere and used to carry on commerce among the States; that, where property is a part of a system and has its actual use only in connection with other parts of the system, that fact may be considered even though other parts of the system are outside the State; that the State may not tax property outside its jurisdiction belonging to one domiciled elsewhere, and that the mileage basis of apportionment

cannot be adopted in the taxation of railroad franchises where the result is shown to be arbitrarily excessive. These propositions are derived from the decisions of this court. *Fargo* v. *Hart,* 193 U. S. 490, 499; *Pittsburg, &c., Railway Co.* v. *Backus,* 154 U. S. 421, 427-431; *Union Tank Line Co.* v. *Wright,* 249 U. S. 275, 282; *Wallace* v. *Hines,* 253 U. S. 66, 69.

"The question is whether the State made valid application of the governing principles. The value of tangible property is not involved in this case. The demand of the Commonwealth against the plaintiffs in error was for taxes on intangible properties over and above the amounts that had been paid by the owning companies. And the entire amount added as a basis for additional taxes is attributable only to the lines of the Southern Railway Company in Kentucky. There was no claim for any taxes in respect of the lines of the Cincinnati, New Orleans and Texas Pacific. That company had also reported its earnings and paid taxes on its tangible and intangible properties in Kentucky. These taxes were based on values per mile in excess of the average values per mile for the system arrived at by capitalization of net railway operating income in accordance with the rule applied by the State. No part of the amounts adjudged to have been omitted could properly be assigned thereto. The Mobile and Ohio, the Cumberland Railroad and the Cumberland Railway were held not to be a part of the system. Plaintiffs in error insist that the enforcement of the taxes on these amounts, as measuring the additional values of intangible properties inhering in the lines of the

Southern Railway Company in Kentucky, operates to tax the property of the Virginia company located beyond the borders of Kentucky and that such amounts are arbitrarily excessive.

"The value of the physical elements of a railroad—whether that value be deemed actual cost, cost of reproduction new, cost of reproduction less depreciation or some other figure—is not the sole measure of or guide to its value in operation. *Smyth* v. *Ames,* 169 U. S. 466, 547. Much weight is to be given to present and prospective earning capacity at rates that are reasonable having regard to traffic available and competitive and other conditions prevailing in the territory served. No intangible element of substantial amount over and above the value of its physical parts inheres in a railroad that cannot earn a reasonable rate of return on its bare-bones—as the mere tangible elements properly may be called. See *Omaha* v. *Omaha Water Co.,* 218 U. S. 180, 202.

"The amount adjudged to have been omitted equals an increase on the lines of the Southern Railway Company in Kentucky of $13,555 per mile for 1918 and of $23,730 for 1919. The 1917 average net operating income per mile for the system was the basis for determining the Kentucky franchise taxes for 1918, and the average for 1918 controlled the amount of the 1919 taxes. The average for the system was $3,642 per mile for 1917 and was $3,623 for 1918. The corresponding net income per mile of the Southern Railway Company in Kentucky for 1917 was $878. There was a loss of $4,741 per mile in 1918. The record also shows a loss

in each of the years 1914, 1915 and 1916. The average for the five years was a loss of $1,230 per mile per year.

"If considered alone, the railroad of the Southern Railway Company in Kentucky would be a losing venture. Its operating loss was more than $157,000 per year for the average of the five years reported in the record. But, assuming it a part of the system, it is right to take into consideration the parts outside the State that are operated in connection with it. The mileage used as an integral part of a railroad system may have elements of value that it otherwise would not possess, and the State properly may have regard to the whole in order to ascertain the value of the part that is within its borders. *Fargo* v. *Hart, supra,* 499. But, if the method pursued in valuing property within the State is arbitrary and the resulting valuation is grossly excessive, the tax must be condemned as in contravention of the due process clause of the Fourteenth Amendment. *Union Tank Line Co.* v. *Wright, supra,* 282, and cases cited. It is not permissible for the State to take into account any of the outside property 'unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State.' *Wallace* v. *Hines, supra,* 69.

"The operating results of the system compared with those of the Southern Railway Company in Kentucky show that, on the basis of valuation adopted by the State, the average value per mile of the lines of that company is very much less than the average value per mile of the system. If taken separately it is clear that, because of lack of net earnings, no substantial intan-

gible elements of value could reasonably be attributed to the railroad of that company. In order to justify the increases made, there would have to be attributed to these lines large amounts from system earnings. To sustain the addition for 1919, it is necessary to take enough to overcome the deficit of $4,741 per mile plus a fair return on the value of the physical property and on the $23,730 per mile fixed as a basis for additional taxes. The draft on earnings from other parts of the system to sustain the increase for 1918 would not be so heavy. But it is equally obvious that there is no foundation for the finding that there existed in these lines intangible values of $1,730,090 or any other substantial amount in excess of the value fairly to be attributed to the physical elements of the railroad. If intangible elements were attributed to the system at the same rate per mile as results from the distribution of the added amount to the mileage of the Southern Railway in Kentucky, their value would be more than $200,000,000 for 1919 and more than $120,000,000 for 1918. Clearly there is no foundation for any such results. The mere statement of the figures is sufficient to show that the amount added as a basis for franchise taxes is so excessive and unreasonable that it cannot be sustained; and such an application of the system earnings amounts to an attempt to tax property outside the State. And as the direct earnings per mile of the lines of that company are so much less than the average for the system, it is plain that the amount adjudged to have been omitted was arbitrarily excessive and included values of system property beyond the limits of Kentucky. * * *

"The enforcement of the franchise taxes so assessed would violate the due process clause of the Fourteenth Amendment."

On account of what transpired in the State Court after the above opinion, we call especial attention to a few pertinent points in the opinion:

1. "A company's railway *system* is deemed to include lines operated, leased or controlled whether technically owned or not. The tax is on intangible property. Where the railroad is partly within and partly without the State, the value of the intangible property so to be taxed may be determined substantially as follows: capitalize the net railway operating income of the entire system for the accounting year last ended; assign to Kentucky its mileage proportion of that amount; deduct the assessed value of the tangible property otherwise taxed; and the remainder is the value taken as the basis for the franchise taxes" (274 U. S. 76, 78).

In other words, this Court holds that the franchise value of the 127.63 miles, which the State Court held was in reality the appellant, the Virginia corporation, should under Kentucky Statutes be calculated by using the net income and mileage of the entire *system* of the Virginia corporation. This Court also holds that the system includes lines operated, leased or controlled by the Virginia corporation.

2. "Stipulated facts tended to show that the Virginia company *controlled* the Cincinnati, New Orleans and Texas Pacific" (274 U. S. 76, 79).

Therefore, since the first record in this case showed that the Virginia company *controlled* the Cincinnati, New Orleans and Texas Pacific, the income and mileage of the Cincinnati, New Orleans and Texas Pacific were necessarily included in the calculation of the Virginia company's franchise.

The stipulation (R. 270) filed in the State Court after the reversal by this Court shows that in the calculation used to make up the prior judgment of $1,730,090.02 for 1918, and $3,028,592.62 for 1919, the income, outside values, mileage, and every other pertinent figure of the Cincinnati, New Orleans and Texas Pacific Railway Company was included. Such figures had to be included since the Cincinnati, New Orleans and Texas Pacific was "controlled" by the Virginia corporation.

In other words, on the prior appeal to this Court the fact that the Cincinnati, New Orleans and Texas Pacific Railway Company was *controlled* by the Virginia corporation, and all necessary figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were already in the record. The figures for the Cincinnati, New Orleans and Texas Pacific Railway Company are in the "Additional Stipulation of Facts" filed May 20, 1922 (R. 182) and "as pleaded in said Amended Answer" also filed May 20, 1922 (R. 177).

The Kentucky Court of Appeals and this Court have each held that where a railroad owns a majority of the stock of another company so that it may elect its directors and dictate its policy, it controls the second road

within the meaning of the Statute, and that the figures of such "controlled" road must be included in the calculation of the franchise of the owning road.

Commonwealth v. L. & N., 149 Ky. 829-838.

> "If the railroad company owns a majority of the stock of another company so that it may elect its directors and dictate its policy, there can be no doubt that it controls it within the meaning of the statute, and that such other railroad should be included in the report required to be made to the Auditor."

The above excerpt from 149 Ky. 829 is copied in full by this Court in the case of Louisville and Nashville Railroad Company v. Greene, 244 U. S. 522-549.

The record on the first appeal to this Court showed the "control" of the Cincinnati, New Orleans and Texas Pacific Railway Company by the Virginia corporation to be an indirect stock ownership control as follows:

Answer to Interrogatory No. 17 (R. 38 and R. 96).

> "Prior to and since January 1, 1917, a corporation called the Southwestern Construction Company owned a majority of the voting stock of the Cincinnati, New Orleans and Texas Pacific Railway Company. The Southern Railway Company owned a certain number of shares of the stock of the Southwestern Construction Company, and the Alabama Great Southern Railroad Company owned a certain number of the shares of the stock of the said Southwestern Construction Company. The Southern Railway Company owned a majority

of the stock in the Alabama Great Southern Railroad Company. The ownership of the Southern Railway Company and of the Alabama Great Southern Railroad Company in the stock of the Southwestern Construction Company was less than half of said stock. Since January 1, 1917, the amount of stock in the Southwestern Construction Company owned by the Southern Railway Company and the Alabama Great Southern Railroad Company has been more than half of said stock."

In other words, the Virginia corporation does not directly own a controlling interest in the Cincinnati, New Orleans and Texas Pacific Railway Company.

A majority of the stock of the Cincinnati, New Orleans and Texas Pacific Railway Company is owned by a separate corporation, to-wit, the Southwestern Construction Company. The Southern Railway Company does not even own a majority of the stock of the Southwestern Construction Company. However, the Southern Railway Company owns a certain number of shares of the Southwestern Construction Company and the Alabama Great Southern also owns a certain number of shares in the Southwestern Construction Company. The Southern Railway Company owns a majority of the stock of the Alabama Great Southern. The stock of the Southern Railway Company and the stock of the Alabama Great Southern Railroad Company together is a majority of the stock of the Southwestern Construction Company. Therefore, only in this very indirect way can the Southern Railway Company be said

to control the Cincinnati, New Orleans and Texas Pacific.

Except for this indirect control for the years 1917 and 1918, there would be, as the Kentucky Court of Appeals held in 204 Ky. 388, no connection between the Kentucky mileage and the rest of the system and consequently no possible basis of a claim for "system" valuation.

We deem it important to emphasize here and to especially call the Court's attention to the fact that when this case was here on the prior appeal—

(a) The record showed the control of the Cincinnati, New Orleans and Texas Pacific Railway Company by the Virginia corporation.

(b) Under the Kentucky Statutes the carrier's system included lines operated, leased or controlled.

(c) The Cincinnati, New Orleans and Texas Pacific Railway Company being a controlled line of the Virginia company, its income, mileage, etc., was necessarily a part of the calculation to determine the value of the Virginia company's franchise.

(d) All figures of income, mileage, etc., for the Cincinnati, New Orleans and Texas Pacific Railway Company were in the record by stipulation.

Clearly, therefore, the fact that the Virginia company controlled the Cincinnati, New Orleans and Texas Pacific Railway Company was an admitted stipulated fact in the prior record. Its figures of income, mileage,

etc., were in the record and were actually used in calculating the judgment that this Court reversed.

In the record that came here on the prior appeal, it appeared without contradiction that the Kentucky corporation, which the State Court held was in reality the appellant, the Virginia corporation, and whose franchise value the Court attempted to assess, had an operating history as follows:

1914	Net Loss	$199,032.45
1915	Net Loss	181,624.96
1916	Net Loss	12,459.48
1917	Net Income	112,075.66
1918	Net Loss	605,191.04

or as stated by this Court:

> "The corresponding net income per mile of the Southern Railway Company in Kentucky for 1917 was $878. There was a loss of $4,741 per mile in 1918. The record also shows a loss in each of the years 1914, 1915 and 1916. The average for the five years was a loss of $1,230 per mile per year.
>
> "If considered alone, the railroad of the Southern Railway Company in Kentucky would be a losing venture. Its operating loss was more than $157,000 per year for the average of the five years reported in the record" (274 U. S. 76, 82).

The prior record also showed that the average net income for the entire system of the Virginia corporation, *i. e.*, all lines owned, operated, leased or controlled, including the Cincinnati, New Orleans and Texas Pacific, was—

"The average for the system was $3,642 per mile for 1917 and was $3,623 for 1918" (274 U. S. 76, 82).

The record further showed that the net railway operating income of the Cincinnati, New Orleans and Texas Pacific Railway Company considered alone was $14,736.92 per mile for 1917, and $9,037.11 per mile for 1918.

It had been stipulated in that record that the Cincinnati, New Orleans and Texas Pacific Railway Company had paid tangible and franchise taxes based on the above earnings.

"For each year it (the C. N. O. & T. P.) reported to the State Tax Commission in its own name and was so taxed on the basis of the assessment set out in the Amended Answer" (Stipulation, R. 181-183).

Since the record showed the above facts of Southern Railway Company in Kentucky earnings per mile, of system earnings per mile, and of Cincinnati, New Orleans and Texas Pacific earnings per mile, it was obvious that the Cincinnati, New Orleans and Texas Pacific as a separate entity had already paid taxes to the State of Kentucky on values very much larger than the values of the system of the Virginia corporation. As this was true, there could be no claim for any additional taxes on account of the Cincinnati, New Orleans and Texas Pacific Railway Company. The Court, therefore, in its prior opinion made the following statement of fact:

"There was no claim for any taxes in respect of the lines of the Cincinnati, New Orleans and Texas Pacific. That company had also reported its earnings and paid taxes on its tangible and intangible properties in Kentucky. These taxes were based on values per mile in excess of the average values per mile for the system arrived at by capitalization of net railway operating income in accordance with the rule applied by the State."

In the above quotation the Court merely made a statement of fact, *i. e.*, that the Cincinnati, New Orleans and Texas Pacific Railway Company as a separate entity had paid taxes on per mile income largely in excess of the per mile income of the system; that therefore the suit was not and could not be a suit for taxes against the Cincinnati, New Orleans and Texas Pacific, but a suit for taxes against the Virginia corporation, which the State Court had held was in fact and in reality the 127.63 miles of the Southern Railway Company in Kentucky.

Immediately following the opinion of this Court (now reported in 274 U. S.), the Commonwealth of Kentucky filed a Petition for Rehearing vigorously calling the attention of this Court to the fact that the Commonwealth did claim taxes growing out of the Cincinnati, New Orleans and Texas Pacific control by the Virginia corporation; that the control of the Cincinnati, New Orleans and Texas Pacific by the Virginia corporation was already in the record; that the figures for the Cincinnati, New Orleans and Texas Pacific Railway Company were already in the record, and that

in this suit against the Virginia corporation for franchise taxes, the Cincinnati, New Orleans and Texas Pacific, as a controlled road of the Virginia corporation, was necessarily included in the calculation and before this Court.

The following excerpts from the Petition for Rehearing filed in this Court by appellee are important:

> "* * * This Court in its opinion says '*there was no claim for any taxes in respect to the lines of* the Cincinnati, New Orleans and Texas Pacific.' We submit that in this the Court has mistaken the record. Kentucky did claim taxes growing out of the C. N. O. & T. P. operation and ownership by the Southern system. The facts essential to make out this state of affairs were positively pleaded in an amended answer filed May 20, 1922, Record 139, in which the stock control and physical operating control were set up fully. * * *
>
> "These pleadings and this stipulation of facts have always been treated by all parties to this controversy as entirely sufficient to raise the question whether the facts as stated were sufficient to warrant a basis of unit taxation of the entire system, including the C. N. O. & T. P. for the two years mentioned. * * *
>
> "We submit that the statement in the opinion of this court that there was no claim for any taxes in respect to this line is a serious misstatement of the facts contained in the record. Taxes have always been claimed since these pleadings went into the record and it has always been admitted that if the pleadings and stipulations were sufficient to make out a case then the case was established; they

were put in for the purpose of testing whether the case really existed.

"* * * We are unable to understand the statement in the opinion of this court that there was no claim for taxes on the part of the Commonwealth for the C. N. O. & T. P. mileage, when the facts essential to make out the claim were stipulated to the court by agreement. They are pleaded by one party and admitted by the other and they are contained in the judgment of the court and that judgment was affirmed by the Court of Appeals because this railroad made a physical connection and rendered the system a unit. In fact the thing that distinguishes the first suit from the second is the claim against this railroad as a unifying factor.

* * * * * * * *

"Not only so but the facts were agreed and the case submitted to the court for judgment thereon as to what assessment, if any, against the Southern should be made. If it be true that the reply should have been filed as an amended petition this is immaterial. It was so treated by the circuit court. It was so treated by the Court of Appeals. The objection was not in fact made here in brief or on the oral argument. The C. N. O. & T. P. was the basis of our case and everybody so understood. The case was really tried on the agreed facts."

We have, therefore, the solemn statements of counsel for the Commonwealth of Kentucky that the Commonwealth had always for the years 1918 and 1919 claimed taxes on account of the control of the Cincinnati, New Orleans and Texas Pacific Railway Company by the Virginia corporation; that all of the facts and

figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were included in the record on the first appeal to this Court.

The reversal by this Court in 274 U. S. 76 was not on account of any defect in the pleadings. The reversal was because this Court held that to put an additional franchise value of $13,555 per mile for 1918, and $27,730 per mile for 1919, on a line of road that had a net income for the first year of only $878 per mile, and a net loss the next year of $4,741 per mile, was "arbitrarily excessive and included values of system property beyond the limits of Kentucky."

As stated by the Commonwealth in its Petition for Rehearing in this Court, all facts with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were in the prior record by stipulation. This Court and the Kentucky Court of Appeals have held that a stipulation takes the place of both pleading and proof.

Saltonstall v. Russell, 152 U. S. 628-630.

> "This case having been submitted to the Circuit Court upon a statement of facts agreed by the parties, or case stated, upon which the Court was to render such judgment as the law required, all questions of the sufficiency of the pleadings were waived, and the want of an answer was immaterial; and no finding of facts by the court was necessary. Williard v. Wood, 135 U. S. 309, 314; Bond v. Dustin, 112 U. S. 604, 607."

Lincoln County Bd. of Education v. Bd. of Trustees, 225 Ky. 21-24, 7 S. W. (2d) 499.

> "In addition the point was decided adversely to the contention of appellant in the case of Lodge, *et al.*, v. Williams, *et al.*, 195 Ky. 773, 243 S. W. 1011. In that case it was held that the parties to a suit in a court of general jurisdiction may agree as to the subject matter of their litigation and waive the objection that the issue was not embraced by the pleadings."

Under the authority of these cases and others that might be cited no pleading was necessary as to the Cincinnati, New Orleans and Texas Pacific Railway Company since the facts with reference thereto were, as stated by the Commonwealth in its Petition for Rehearing, stipulated to the Court.

In addition, from the moment the Kentucky Court of Appeals held that the 127.63 miles of Southern Railway Company in Kentucky were in fact and in reality but a division of the Virginia corporation, all figures of every controlled road of the Virginia corporation, which necessarily included the figures of the Cincinnati, New Orleans and Texas Pacific as one of such controlled roads, was in the record and before the Court without the necessity of one word of pleading.

After the reversal by this Court, it was stipulated in the Kentucky Circuit Court (R. 270 to 274) that in the calculation used in arriving at the judgment for 1918—subsequently reversed by this Court—the following figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were used:

Net railway operating income, C. N. O. & T. P.	$4,970,326.01
Total outside excess tangible values, *i. e.*, shops, terminals and double tracks, C. N. O. & T. P.	$1,019,582.15
Entire mileage, C. N. O. & T. P.	337.27
Kentucky mileage, C. N. O. & T. P.	197.50
Values heretofore paid on tangible and intangible property in Kentucky by C. N. O. & T. P.	$9,181,368.00

The stipulation showed corresponding figures for the year 1919.

Because of the most unusual proceedings in the State Court, after the reversal by this Court, we have emphasized the fact that—

(1) the control of the Cincinnati, New Orleans and Texas Pacific Railway Company by the Virginia corporation,
(2) all figures with reference to the Cincinnati, New Orleans and Texas Pacific,
(3) the claim of the Commonwealth for taxes on account of this control of the Cincinnati, New Orleans and Texas Pacific, and
(4) the inclusion of the Cincinnati, New Orleans and Texas Pacific in the actual calculation used in the judgment reversed in 274 U. S. 76,

were each and every one in the record on the prior appeal.

Such facts are shown by:

(a) The opinion of this Court.

(b) The Petition for Rehearing filed by the Commonwealth.

(c) The stipulation in the present record (R. 270) showing the calculations actually used in arriving at the prior judgment.

The case was reversed by this Court and "remanded to the said Court of Appeals for further proceedings not inconsistent with the opinion of this Court" (R. 234). The Kentucky Court of Appeals in turn remanded the case to the State Circuit Court with directions "for further proceedings not inconsistent with the opinion of the Supreme Court of the United States" (R. 235).

Subsequently and on November 2, 1928, the Commonwealth filed an Amended Statement (R. 236). This Amended Statement opens with the allegation that it is—

> "filed for the purpose of making a claim for taxes *against* the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company" (R. 236).

There then follows allegations to the effect that the Virginia corporation *controlled* the Cincinnati, New Orleans and Texas Pacific Railway Company. These allegations were followed by other allegations to which neither the Circuit Court nor the Kentucky Court of Appeals paid any attention, and may therefore be disregarded.

The prayer is in part as follows:

> "WHEREFORE plaintiff prays that this its amended statement be treated as a claim *against* said Cincinnati, New Orleans and Texas Pacific Railway; that the lines and values of said C. N. O. & T. P. be included in the valuations of defendant's property; * * *" (R. 242).

Similar allegations were made as to the year 1919.

It will thus be seen that the Commonwealth attempted to make a direct claim *against* the independent and separate railroad corporation known as the Cincinnati, New Orleans and Texas Pacific Railway Company. Since the Southern Railway Company, the Virginia corporation, and the Director General of Railroads were the only parties defendant to the suit, it was clear that there could be no claim against or judgment recovered from the Cincinnati, New Orleans and Texas Pacific Railway Company. Subsequently the Commonwealth filed an additional Amended Statement alleging that the word "against" was in error, and that what they meant to say was that the Amended Statement be treated as a claim against the Virginia corporation and the Director General of Railroads "by reason of" the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company (R. 278).

Therefore, the only pertinent matter in the Amended Statement was the allegation that it was filed for the purpose of making a claim either "against" or "in respect of" the lines of the Cincinnati, New Orleans and Texas Pacific.

On the same date, to-wit, November 2, 1928, answer was filed by the Southern Railway Company, the Virginia corporation, and the Director General of Railroads (R. 243) making appropriate denials and affirmatively alleging that theretofore and on May 20, 1922, a judgment had been rendered in the Circuit Court adjudging that for the taxing year 1918, the value of the franchise of the Virginia corporation omitted from taxation was $1,730,090.02, and for 1919 was $3,028,592.62; that these values were arrived at according to a calculation which is set out in detail; that this judgment was affirmed by the Kentucky Court of Appeals and was afterwards reversed by the Supreme Court in 274 U. S. 76; that to assess taxes against the defendants, or either of them, on the basis of the calculations thus set out in detail—

> "would be a violation of the Constitution of the State of Kentucky, and a violation of the Constitution of the United States, particularly the due process and equal protection clause of the Fourteenth Amendment thereof" (R. 243-261).

The answer further alleges:

> "The effort made herein is simply for the purpose of endeavoring to bring into the State of Kentucky for the purposes of taxation, property not in Kentucky, and values appertaining to property not in Kentucky, and earnings derived from property not in Kentucky; that to do this would be a violation of the Constitution of the State of Kentucky, and the Constitution of the United States, particularly the due process and equal protection

clauses of the Fourteenth Amendment thereof" (R. 243-265).

The answer also pleads the net railway operating income per mile of appellant's system (including the Cincinnati, New Orleans and Texas Pacific) at $3,641.75 per mile for 1918 taxes, and $3,623.81 per mile for 1919 taxes, and that the net railway operating income of the Southern Railway Company in Kentucky is only $878.19 per mile for 1918 taxes and net deficit of $4,742.13 per mile for 1919 taxes.

A reply was filed on the same date (R. 266), and additional stipulations were filed (R. 270). These stipulations set out in detail the method of calculation used in the prior judgment that was reversed (R. 270 to 274), and that this method of calculation was the method universally, systematically and intentionally used by the taxing authorities of the State of Kentucky with regard to franchise tax assessments of all common carriers having lines within and without the State.

It must be remembered that in the prior record it was shown that the Southern Railway Company in Kentucky, the Cincinnati, New Orleans and Texas Pacific Railway Company, and each of the other Kentucky railroads controlled by stock ownership, had paid full tangible and franchise taxes on their separate properties; that the Cincinnati, New Orleans and Texas Pacific Railway Company had paid a franchise tax assessment on earnings in excess of $14,700.00 per mile for 1918 and in excess of $9,000.00 per mile for 1919,

whereas the "system" income was less than $4,000 per mile for each of the years.

On the same date, to-wit, November 2, 1928, the Woodford Circuit Court entered a judgment adjudging that the omitted franchise of the Virginia corporation for 1918 was $1,730,090.02, and for 1919 was $3,028,592.62. The figures and method of calculation used by the Court to fix these present valuations are set out in detail in the judgment (R. 278 to 284); and a comparison with the stipulation showing the figures and method of calculation used in the prior judgment (R. 270 to 274) will show that the method, calculations and figures in the present judgment are identical with the method, calculations and figures used in the judgment that was reversed.

An appeal was taken from this judgment to the Kentucky Court of Appeals. The latter Court, in an opinion, dated March 27, 1930, affirmed the judgment of the lower Court (R. 290).

The constitutional question, *i. e.*, that the proposed additional franchise tax was arbitrarily excessive and included values of property and earnings from property located outside of the State of Kentucky, was raised in the original pleadings and in the answer filed after the reversal by this Court. The answer also alleged facts showing that the earnings of the Southern Railway Company in Kentucky were less than the "system" earnings of appellant.

The Kentucky Court of Appeals in its opinion of March 27, 1930 (R. 290), considered each of these con-

stitutional questions and passed on them adversely to appellants.

After the opinion of the Kentucky Court of Appeals, a petition for rehearing was filed in the Court of Appeals (R. 315). This Petition for Rehearing again stressed the constitutional questions. The Petition for Rehearing was overruled without opinion on the 5th day of June, 1931 (R. 355).

The appellants, Southern Railway Company and Director General of Railroads, each filed separate assignments of errors (R. 356; R. 360). Both of the appellants rely upon and urge the following assigned errors:

1. The Kentucky Court of Appeals has not obeyed or carried out the mandate or opinion of this Court reported in 274 U. S. 76 (R. 356, 360).

2. With no new question of law or fact in the record, the State Court has affirmed the same judgment that had been reversed by this Court (R. 356, 360).

3. The State Court erroneously assumed that the prior reversal by this Court was because of the failure of appellee to plead or make claim for taxes in respect of the Cincinnati, New Orleans and Texas Pacific Railroad Company, when such reversal was upon the merits of the case and not upon any failure or defect of pleading (R. 357, 360).

4. The State Court erred in assuming that any special claim or pleading in respect of the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company was necessary in order to in-

clude any claim for franchise taxes that appellee might have against the Southern Railway Company and the Director General of Railroads, or either of them (R. 357, 360).

5. The State Court erred in holding that the pleadings, stipulations of the parties and the record on the first appeal to this Court were not sufficient to present all claims of the Commonwealth of Kentucky for franchise taxes against the appellants, or either of them in respect of the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company as a part of the system of the Southern Railway Company (R. 357, 361).

6. The State Court erred in holding that Kentucky Statutes, Sections 4077 to 4091, inclusive, and each of them, as construed, interpreted and applied by the Kentucky Court of Appeals in this cause, were not repugnant to the due process clause of the Fourteenth Amendment, and in deciding in favor of the validity of said statutes, and each of them, over such constitutional objections interposed respectively by each of the appellants (R. 357, 361).

7. The State Court erred in holding that the assessments upheld by it for each of the years in controversy for the purpose of franchise assessment and taxation, did not have the effect of bringing into Kentucky for purposes of assessment and taxation property not in Kentucky, and values appertaining to property not in Kentucky, and income derived from property not in Kentucky, each and all of which holdings are contrary to the due process clause of the Fourteenth Amendment as claimed by each of the appellants, and as held by

this Court in its prior opinion of reversal (R. 357, 361).

8. The State Court erred in holding that the adoption of the mileage system of valuation for the Southern Railway System as applied to the assessment for franchise taxes for each of the years involved herein was not void because of the different character and value of the lines outside of Kentucky from the lines in Kentucky, which precluded the application of the per mile method of valuation, each and all of which holdings were contrary to the due process clause of the Fourteenth Amendment as claimed by each of the appellants, and as held by this Court in its prior opinion of reversal (R. 358, 361).

9. The State Court erred in holding that the assessments for franchise taxes and the tax for such purpose for each of the years involved herein was not void because such additional assessment based on mileage outside of Kentucky was so arbitrary and unreasonable in amount as to violate the due process clause of the Fourteenth Amendment as claimed by each of the appellants and as held by this Court in its prior opinion of reversal (R. 358, 362).

10. The State Court erred in distributing the assessment of the franchise value found by the Court to be due for each of the years in controversy from the appellants over the mileage of the Cincinnati, New Orleans and Texas Pacific Railway Company because the franchise sought to be assessed was solely the franchise of the Southern Railway Company and not the franchise of the Cincinnati, New Orleans and Texas Pacific Railway Company, which last named company was not

even a party to this proceeding and because the Cincinnati, New Orleans and Texas Pacific Railway Company had fully paid all of its franchise taxes for each of said years, each and all of which holdings were contrary to the due process clause of the Fourteenth Amendment as claimed by each of the appellants and in conflict with the prior opinion of reversal by this Court (R. 358, 362).

The appellant, Southern Railway Company, further relies upon the following assigned errors:

1. The State Court erred in holding that any assessment for franchise purposes, or any tax levied thereon, or any lien therefor, could be upheld or enforced against the Southern Railway Company, or its property, or that any judgment for taxes could be rendered against the Southern Railway Company for either of the years in controversy inasmuch as it appeared that the property of the Southern Railway Company was, during each of said years, in the possession and under the control and operation of the Director General of Railroads, each and all of which holdings were violative of the due process clause of the Fourteenth Amendment, and laws of the United States with relation to Federal control and operation of railroads, as claimed herein by the appellant, Southern Railway Company (R. 359).

2. The State Court erred in holding that a penalty should be adjudged against the Southern Railway Company on account of failure to list its property for assessment and taxation during each of the years in controversy, the property of the Southern Railway Company during each of said

years being in the possession and under the control and operation of the Director General of Railroads under the proclamation of the President and the Acts of Congress relating to Federal control and operation of railroads, and the Southern Railway Company being under no duty or obligation to return any of its property for assessment for either of said years (R. 359).

The appellant, Director General of Railroads, further relies upon the following assigned error:

1. The State Court erred in holding that any penalty could be assessed against the Director General of Railroads because of any failure on his part to list for assessment for either of the years in controversy any property of the Southern Railway Company, which was in the possession and under the control and operation of the Director General of Railroads during the taxable years in controversy, or that any penalty could be assessed against the Director General of Railroads on account of his failure to pay franchise taxes for either of said years, the assessment of such penalties being in violation of the Proclamation of the President, and the laws of the United States relating to Federal control and the operation of railroads, as claimed herein by the Director General of Railroads (R. 362).

ARGUMENT.

There is, therefore, presented the unusual situation of an appeal from a judgment of the Kentucky Court of Appeals with no new fact in the record which is identical in amount, method of calculation, and every other detail with a judgment of that Court that has been heretofore reversed by the Supreme Court.

The opinion of the Kentucky Court of Appeals (R. 290) is quite long. However, the Court gives two reasons for affirming the judgment and reversing the decision of this Court. The first of these reasons is as follows:

> "It is the contention of counsel for the Southern Railway Company that the opinion of the Supreme Court was based upon exactly the same facts that now appear of record. In view of what has been said in this opinion we cannot agree with that contention. In the amended petition which was filed making claim for taxes in respect of the lines of the Cincinnati, New Orleans and Texas Pacific Railway Company a new question was presented. It cannot be said now that there is not any claim for taxes by reason of the control of the Cincinnati, New Orleans and Texas Pacific Railway Company" (R. 290-310; 238 Ky. 638-657).

Stated in another way, the Kentucky Court of Appeals holds that the mere allegation in an amended statement that it is—

> "filed for the purpose of making a claim for taxes by reason of the lines of the Cincinnati, New Orleans and Texas Pacific" (R. 236-238),

presents a new question.

We have shown above:

1. By the opinion of this Court that the stipulations then presented to this Court showed that the Virginia corporation *controlled* the Cincinnati, New Orleans and Texas Pacific, and that the franchise tax was assessed by using income and *mileage of all* operated, leased or controlled roads.
2. That all facts and figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were in the first record by stipulation and that a stipulation takes the place of both pleading and proof.
3. That the Commonwealth in its Petition for Rehearing in this Court correctly stated that it had during all of the time been making claim for taxes on account of the Virginia corporation's *control* through stock ownership of the Cincinnati, New Orleans and Texas Pacific, and that all facts and figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were in the record by stipulation.
4. That by the Kentucky Statutes as interpreted by this Court and by the Kentucky Court of Appeals in cases of common carriers extending within and without the limits of Kentucky, figures of all controlled roads are a necessary part of the calculation in fixing a franchise valuation. The Virginia corporation controlled a very large number of railroads, and in order to include the figures of such controlled roads, it was not necessary that any special allegation

or pleading be filed concerning each of such controlled roads.

5. It is shown by the stipulation (R. 270 to 274) that all figures with reference to the Cincinnati, New Orleans and Texas Pacific Railway Company were used in the calculation by which the valuation in the reversed judgment was fixed.

   In other words, the allegation in the amended statement that the appellant, Virginia corporation, *controlled* the Cincinnati, New Orleans and Texas Pacific Railway Company is not a new fact in the record, and it was no more necessary for the Commonwealth to file a pleading "claiming taxes in respect of" the controlled Cincinnati, New Orleans and Texas Pacific, than for it to file other amendments "making claims for taxes in respect of" the other nineteen roads which the Virginia corporation controlled in 1917 (R. 87), or the twenty-two roads which it controlled in 1918 (R. 71).

6. It was shown by stipulation that during the years in controversy the taxing authorities of Kentucky in fixing the value of the franchise of a common carrier had uniformly, systematically and intentionally included all figures of all controlled roads (Stipulation 5; R. 275), and by further stipulation it was shown that all figures with reference to the Cincinnati, New Orleans and Texas Pacific were actually included in the judgment that was reversed by this Court (Stipulation 3; R. 270 to 274).

We are unable, therefore, to reconcile the above facts with the statement of the Kentucky Court of Appeals in its last opinion that the amended petition pre-

sented a new question. Also, in view of all of the above which appears of record, we do not deem it necessary to further argue the point that the amended statement did not present any new question that was not already in the case when it was reversed by this Court.

The other reason given by the Court of Appeals for affirming a judgment imposing taxes on values and property outside of Kentucky, and from earnings on property outside of Kentucky, is because the Kentucky Court said that after deducting excess tangible values, it has always been considered that mileage within and mileage without the State was of equal value.

> "Some of the larger systems of railways operating in Kentucky, own, lease, operate or control mileage that does not yield a large income, but, after eliminating the excess values outside of Kentucky, this mileage has been considered of equal value mile for mile with the other mileage of the system. To allow the Southern Railway Company to escape these additional assessments is to allow it to escape the payment to the State and counties affected of taxes undoubtedly just *if the assessments of railroad properties in Kentucky for the last thirteen years have been correctly made.* * * *"
> (R. 290-312; 238 Ky. 638-659).

When the appellant shows, as has been done in this case, that the 127.63 miles had a net income for 1917 of only $878 per mile, and a net loss in 1918 of $4,741 per mile, and when a judgment assessing an additional valuation of $13,555 per mile for 1918, and of $23,730 per mile for 1919, we submit that it is no answer to the

unconstitutionality of such an assessment for the Court of Appeals of Kentucky to say that the Kentucky mileage "has been considered of equal value mile for mile with the other mileage of the system."

And yet that is the sum and substance of the Kentucky Court of Appeals' opinion in sustaining the unconstitutional assessment—that heretofore Kentucky mileage has always been considered of equal value with outside mileage.

In addition, it is alleged in the answer of the defendants, filed on November 2, 1928, and not denied, that the net railway operating income of the Virginia corporation, and of all owned, operated, leased and controlled lines was $3,641.75 per mile for 1917, and $3,623.81 per mile for 1918, whereas the net railway operating income of the Southern Railway Company in Kentucky—the line which the Court held was but a division of the Virginia corporation, and the line whose franchise value is being assessed was only $878.19 per mile for 1917, and a net deficit of $4,742.13 per mile for 1918.

We do not deem it necessary to reargue points in our original brief and sustained by this Court in its prior opinion that the imposition of such a tax is unconstitutional as bringing into Kentucky for taxation property and earnings derived from property clearly beyond the jurisdiction of Kentucky. The opinion of this Court in this identical case is sufficient (274 U. S. 76).

In the dissenting opinion it was stated the merits of the case were not considered because of a point of practice which was urged by the Commonwealth. Such point of practice cannot now be raised because an amended answer (R. 243) filed in the State Court, following this Court's reversal, clearly raised the constitutional question and in argument, and in brief, and in the Petition for Rehearing (R. 315), each constitutional question was fully argued and brought to the attention of the Kentucky Court of Appeals, and each constitutional question decided adversely to appellants.

To our knowledge, this case is without parallel, *i. e.*, the affirmance by a State Court of the exact judgment that had been reversed by this Court with no new fact appearing in the record.

The opinion of the Court of Appeals erroneously states that:

> "It was the duty of the Southern Railway Company to make a report giving its total mileage of all roads owned, operated, leased or controlled, and the net income for such roads. It failed to do that and allowed two controlled roads mentioned to make separate reports. If the Southern Railway Company had made the reports required by the statute * * *. This was brought about by the failure of the Southern Railway Company to comply with the law" (R. 290-311; 238 Ky. 638-659).

As a matter of fact, it is stipulated in the record that during the years in question the railroad prop-

erty of the Southern Railway Company was taken over by the Government of the United States. The railroad companies had nothing whatever to do with their property and had no figures from which the various tax reports could be made. All reports were made by the Director General of Railroads and not by the railroad corporations.

The opinon of the Court of Appeals is further erroneous in three particulars:

(1) The alleged increase is spread over the mileage of the Cincinnati, New Orleans and Texas Pacific Railway Company.
(2) The judgment is against both the defendant corporation and the Director General of Railroads.
(3) The judgment attempts to impose a penalty against the Director General of Railroads.

These will be discussed in the order named:

1. THE ALLEGED INCREASE IS SPREAD OVER THE MILEAGE OF THE CINCINNATI, NEW ORLEANS AND TEXAS PACIFIC RAILWAY COMPANY.

It must be remembered that this suit is against the Virginia corporation; that it is against the Virginia corporation only because the Kentucky Court of Appeals held that the 127.63 miles of road belonging to the Kentucky corporation was in fact the Virginia corporation, and that franchise taxes should be assessed as though the mileage of the Southern Railway Company in Kentucky were but a division of the Virginia corporation. In other words, since the Southern Railway Company in Kentucky as a separate corporate

entity has paid its own franchise tax, the sole purpose of the suit is to ascertain and fix the added value, if any, that belongs to its 127.63 miles, because the Court of Appeals has said that it was but a division of the Virginia corporation instead of a separate corporate entity.

There is no attempt here to collect any additional tax from or against the separate Cincinnati, New Orleans and Texas Pacific Railway Company. It is error, therefore, to spread any alleged increase in franchise value over the lines of that road. The Cincinnati, New Orleans and Texas Pacific Railway Company has paid its own franchise tax based on earnings more than three times as large as the earnings of the entire system of appellant, including the earnings of the Cincinnati, New Orleans and Texas Pacific Railway Company as a part of such system.

This same error on the part of the Court of Appeals of Kentucky was condemned by this Court in the prior opinon.

2. THE JUDGMENT IS AGAINST BOTH THE DEFENDANT CORPORATION AND THE DIRECTOR GENERAL OF RAILROADS.

The tax in question is a property tax, *i. e.*, a tax on the intangible property of a corporation.

Greene v. Louisville & Interurban R. R. Co., 244 U. S. 499.
Henderson Bridge Co. v. Commonwealth, 99 Ky. 623, 166 U. S. 150.

The Director General of Railroads took possession on December 28, 1917, as of December 31, 1917, under a proclamation of the President. An Act was subsequently passed and approved on March 21, 1918, confirming the conduct of this Federal Administration of Railroads (U. S. Comp. Stats. Anno. Supp. 1919-1923, Sec. 3115¾, *et seq.*, 40 Stat. at Large, 457).

This Act specifically provided that all taxes assessed against the property of the railroads during Federal control should be paid by the Government. Section 1 of the Acts provides as follows:

> "Every such agreement shall provide that any Federal taxes under the Act of October third, nineteen hundred and seventeen, or Acts in addition thereto, or in amendment thereof, commonly called war taxes, assessed for the period of Federal control beginning January first, nineteen hundred and eighteen, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation; that other taxes assessed under Federal or any other governmental authority for the period of Federal control or any part thereof, either on the property used under such Federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation (not including, however, assessments for public improvements or taxes assessed on property under construction, and chargeable under the classification of the Interstate Commerce Commission to investment in road and equipment), shall be paid out of revenues derived from railway opera-

tions while under Federal control; that all taxes assessed under Federal or any other governmental authority for the period prior to January first, nineteen hundred and eighteen, whenever levied or payable, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation."

Section 15 of the Act provides as follows:

> "That nothing in this Act shall be construed to amend, repeal, impair, or affect the existing laws or powers of the States in relation to taxation or the lawful police regulation of the several states, except wherein such laws, powers or regulations may affect the transportation of troops, war materials, Government supplies, or the issue of stocks and bonds."

These taxes, therefore, being property taxes are not the liabilities of the railroad corporation. The General and Special Demurrers of the Railway Company should be sustained.

This Court and the Kentucky Court of Appeals have frequently held that the Director General alone was responsible during Federal control, and that the above Federal control act was supreme even where it conflicted with the State law.

Davis, Director General, v. Dantzler Lbr. Co., 261 U. S. 280.
North Carolina R. Co. v. Lee's Adm'x, 260 U. S. 16.

3. THE JUDGMENT ATTEMPTS TO IMPOSE A PENALTY AGAINST THE DIRECTOR GENERAL OF RAILROADS.

That the twenty per cent (20%) added in the judgment is a penalty appears from the statute itself—4241 Kentucky Statutes. Thus it is said in this statute:

> "All persons owning property which may be assessed as herein provided shall, in addition to the taxes, pay a penalty of twenty per centum on the amount of the taxes due and cost of assessment, except where such property shall have been duly listed by the owner thereof."

The Kentucky Court of Appeals in its last opinion distinctly calls the twenty per cent a penalty but justified it by saying that the element of punishment does not predominate.

> "* * * The penalty assessed under the Statutes of Kentucky against delinquent taxpayers is not one where the element of punishment predominates. The circuit court was not in error in allowing the penalty" (R. 290-314; 238 Ky. 638-662).

This Court had held that the Director General was not liable for a penalty.

Missouri Pacific R. Co. v. Ault, 256 U. S. 554.

In this case it appears that a statute of Arkansas provided that whenever a railroad company discharged an employe, with or without cause, the railroad company should pay the discharged employe the wages due him within seven days of the discharge. Further, that if payment was not made within the above time, "then as a penalty for such non-payment the wages of such servant or employe shall continue from the date of the

discharge or refusal to further employ at the same rate until paid." In August, 1918, Ault brought suit against the Railroad Company, alleging that he had been employed by the Company at the rate of $2.50 per day; that he had been discharged on July 29, 1918, and that $50.00 was then due him as wages but had not been paid. He recovered judgment by default. The Company appealed to the Circuit Court of the State and there moved in January of 1919 to substitute as the defendant the Director General of Railroads. The Court refused to make this substitution, but joined the Director General as a party defendant and rendered judgment against both the Director General and the Railroad Company upon a verdict that Ault recover the sum of $50.00 due him as wages and $390.00 as penalty. The judgment was affirmed by the Supreme Court of Arkansas.

On appeal to the Supreme Court that Court held:

> "Whatever name be applied, the element of punishment clearly predominates and Congress has not given its consent that suits of this character be brought against the United States. The judgment against the Director General, so far as it provided for recovery of the penalty, was erroneous."

The question was again before this Court in the case of *Norfolk-Southern R. R. Co.* v. *Owens,* 256 U. S. 565. The opinion is very short, and is as follows:

> "This case comes here on writ of certiorari (251 U. S. 550) to the Supreme Court of North Carolina, which affirmed (178 N. Car. 325) a judgment of $21.00 against the Norfolk-Southern Rail-

road Company in favor of Owens, a shipper. The amount was assessed under a statute of the State as a penalty for undue delay in making delivery of an intrastate shipment made March 27, 1918. At that time the railroad was in the possession and control of the Government, and was being operated by the Director General under the Federal Control Act of March 21, 1918, c. 25, 40 Stat. 451. The only question presented for decision is whether the company was liable for the penalty. We are of opinion that it was not, for the reasons stated in Missouri Pacific R. R. Co. v. Ault, decided this day, *ante*, 554."

We submit that the judgment of the Kentucky Court of Appeals should be reversed because:

1. It is a duplicate of the judgment heretofore reversed by this Court.
2. It is an attempt to tax property and earnings from property outside of the State of Kentucky contrary to the Fourteenth Amendment.
3. The property being in the control of the Federal Government no judgment could be entered against the Railroad corporation.
4. No penalty could be assessed against the Director General.

WHEREFORE, we ask that the judgment of the State Court be reversed.

Respectfully submitted,

L. E. JEFFRIES,
S. R. PRINCE,
EDWARD P. HUMPHREY,
CHARLES W. MILNER,
Counsel for Appellants.

APPENDIX.

PRIOR OPINION OF SUPREME COURT OF THE UNITED STATES.
274 U. S. 76.

Method and Figures Used in Calculating Assessment of Judgment that was Reversed

AND

Method and Figures Used in Calculating Assessment of Present Judgment.

APPENDIX

Supreme Court of the United States

Nos. 33 and 34.—October Term, 1926.

Southern Railway Company, Plaintiff in Error,

33 *vs.*

Commonwealth of Kentucky.

James C. Davis, Director General, Plaintiff in Error,

34 *vs.*

Commonwealth of Kentucky.

In Error to the Court of Appeals of the State of Kentucky.

[April 11, 1927.]

Mr. Justice Butler delivered the opinion of the Court.

A judgments against plaintiffs in error for franchise taxes imposed under the laws of Kentucky in respect of certain lines of railway was affirmed by the highest court of that State. 204 Ky. 388. And see 193 Ky. 474. Reversal is sought on the ground that as applies these laws contravene the due process clause of the Fourteenth Amendment.

The statutes* (§§4077-4081) provide that every foreign or domestic railway company, in addition to other taxes imposed by law, shall pay an annual tax on its franchise. The provisions apply whether the privilege is exercised by the corporation in its own name or in the name of another which it adopts. A company's railway system is deemed

*The provisions are printed in the margin of Louis. & Nash. R. R. Co. v. Greene, 244 U. S. 522, at page 533.

to include lines operated, leased or controlled whether technically owned or not. The tax is on intangible property. Where the railroad is partly within and partly without the State, the value of the intangible property so to be taxed may be determined substantially as follows: capitalize the net railway operating income of the entire system for the accounting year last ended; assign to Kentucky its mileage proportion of that amount; deduct the assessed value of the tangible property otherwise taxed; and the remainder is the value taken as the basis for the franchise taxes. When the railroad is wholly within the State, the capitalized net, less the assessed value of tangible property on which other taxes are paid, is taken to be the value of intangible property. *Greene* v. *Louis. & Interurban R. R. Co.*, 244 U. S. 499, 510, and cases cited; *Louis. & Nash. R. R. Co.* v. *Greene*, 244 U. S. 522, 539.

Plaintiff in error, the Southern Railway Company, is a Virginia corporation. The lines of its system of railroads, exclusive of the Kentucky mileage in question, exceed 9,500 miles and extend from Washington, D. C., into Virginia, the Carolinas, Tennessee, Georgia, Florida, Alabama and Mississippi. The company also has a line from New Albany, Indiana, to East St. Louis, Illinois. It does not own any railroad in Kentucky. The "Southern Railway Company in Kentucky" owns 127.63 miles, all of which are in that State. Its branches connect with the line of the Cincinnati, New Orleans and Texas Pacific Railway Company which extends from Cincinnati to Chattanooga and connects it with the system. Its stock is owned by the Virginia company. The same persons are officers of both. The lines of the Kentucky company are reported to public authorities and are advertised as a part of the system. The Mobile and Ohio Railroad Company, the Cumberland Railroad Company and the Cumberland Railway Company own, in all, about 53.3 miles of railroad in Kentucky, but their lines are not connected with the lines of the Southern Railway Company in Kentucky. The Virginia

company through stock ownership controls these companies; but they and the Southern Railway in Kentucky, in their own names and as owners, made reports and paid in full all taxes assessed under Kentucky laws on their tangible and intangible properties.

The Commonwealth brought this suit against the Virginia company and the Director General to recover additional franchise or intangible property taxes for 1918 and 1919 in respect of the Kentucky mileage of these companies. The Court of Appeals held that there was no such connection or unity of use between the system of the Virginia company and the lines of the Mobile and Ohio, the Cumberland Railroad and the Cumberland Railway as would justify recovery of any franchise taxes in respect of their Kentucky mileage. Stipulated facts tended to show that the Virginia company controlled the Cincinnati, New Orleans and Texas Pacific; and the court held that by means of its lines the railroad of the Southern Railway in Kentucky was so connected with the lines of the Virginia company as to be a part of the system. The value of intangible property adjudged to have been omitted, and on which the additional franchise taxes were calculated, for 1918 was $1,730,090.02 and for 1919 was $3,028,592.62. These amounts were arrived at as follows: the net railway operating income for the entire system was capitalized at seven per cent; there was deducted an amount to cover the value of shops, terminals and double tracks outside Kentucky in excess of corresponding tangible property connected with the lines in that State; there was allocated to Kentucky such proportion of the remainder as 424.61 miles, which were attributed to Kentucky, bore to the total mileage of the system; that amount was equalized for taxation at 75 per cent. for 1918 and at 85 per cent. for 1919; and from the result there was deducted the values of tangible and intangible property (including the Kentucky mileage of the Cincinnati, New Orleans and Texas Pacific) on which taxes had been paid. But the average value per mile so

deducted was less than the system average per mile. The amounts so arrived at were assigned to the 127.63 miles of the Southern Railway Company in Kentucky. and the 197.5 miles in Kentucky of the lines of the Cincinnati, New Orleans and Texas Pacific. The increase per mile for 1918 was $5,334.55 and for 1919 was $9,338.34.

The Court of Appeals rightly declared that a State may tax property permanently within its jurisdiction belonging to one domiciled elsewhere and used to carry on commerce among the States; that, where property is a part of a system and has its actual use only in connection with other parts of the system, that fact may be considered even though other parts of the system are outside the State; that the State may not tax property outside its jurisdiction belonging to one domiciled elsewhere, and that the mileage basis of apportionment cannot be adopted in the taxation of railroad franchises where the result is shown to be arbitrarily excessive. These propositions are derived from the decisions of this Court. *Fargo* v. *Hart*, 193 U. S. 490, 499; *Pittsburgh, &c. Railway Co.* v. *Backus*, 154 U. S. 421, 427-431; *Union Tank Line Co.* v. *Wright*, 249 U. S. 275, 282; *Wallace* v. *Hines*, 253 U. S. 66, 69.

The question is whether the State made valid application of the governing principles. The value of tangible property is not involved in this case. The demand of the Commonwealth against the plaintiffs in error was for taxes on intangible properties over and above the amounts that had been paid by the owning companies. And the entire amount added as a basis for additional taxes is attributable only to the lines of the Southern Railway Company in Kentucky. There was no claim for any taxes in respect of the lines of the Cincinnati, New Orleans and Texas Pacific. That company had also reported its earnings and paid taxes on its tangible and intangible properties in Kentucky. These taxes were based on values per mile in excess of the average values per mile for the system arrived at by capitalization of net railway operating income in accordance

with the rule applied by the State. No part of the amounts adjudged to have been omitted could properly be assigned thereto. The Mobile and Ohio, the Cumberland Railroad and the Cumberland Railway were held not to be a part of the system. Plaintiffs in error insist that the enforcement of the taxes on these amounts, as measuring the additional values of intangible properties inhering in the lines of the Southern Railway Company in Kentucky, operates to tax the property of the Virginia company located beyond the borders of Kentucky and that such amounts are arbitrarily excessive.

The value of the physical elements of a railroad—whether that value be deemed actual cost, cost of reproduction new, cost of reproduction less depreciation or some other figure—is not the sole measure of or guide to its value in operation. *Smyth* v. *Ames*, 169 U. S. 466, 547. Much weight is to be given to present and prospective earning capacity at rates that are reasonable having regard to traffic available and competitive and other conditions prevailing in the territory served. No intangible element of substantial amount over and above the value of its physical parts inheres in a railroad that cannot earn a reasonable rate of return on its bare-bones—as the mere tangible elements properly may be called. See *Omaha* v. *Omaha Water Co.*, 218 U. S. 180, 202.

The amount adjudged to have been omitted equals an increase on the lines of the Southern Railway Company in Kentucky of $13,555 per mile for 1918 and of $23,730 for 1919. The 1917 average net operating income per mile for the system was the basis for determining the Kentucky franchise taxes for 1918, and the average for 1918 controlled the amount of the 1919 taxes. The average for the system was $3,642 per mile for 1917 and was $3,623 for 1918. The corresponding net income per mile of the Southern Railway Company in Kentucky for 1917 was $878. There was a loss of $4,741 per mile in 1918. The record also shows a loss in each of the years 1914, 1915 and 1916.

The average for the five years was a loss of $1,230 per mile per year.

If considered alone, the railroad of the Southern Railway Company in Kentucky would be a losing venture. Its operating loss was more than $157,000 per year for the average of the five years reported in the record. But, assuming it a part of the system, it is right to take into consideration the parts outside the State that are operated in connection with it. The mileage used as an integral part of a railroad system may have elements of value that it otherwise would not possess, and the State properly may have regard to the whole in order to ascertain the value of the part that is within its borders. *Fargo* v. *Hart, supra,* 499. But, if the method pursued in valuing property within the State is arbitrary and the resulting valuation is grossly excessive, the tax must be condemned as in contravention of the due process clause of the Fourteenth Amendment. *Union Tank Line* v. *Wright, supra,* 282, and cases cited. It is not permissible for the State to take into account any of the outside property "unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State." *Wallace* v. *Hines, supra,* 69.

The operating results of the system compared with those of the Southern Railway Company in Kentucky show that, on the basis of valuation adopted by the State, the average value per mile of the lines of that company is very much less than the average value per mile of the system. If taken separately it is clear that, because of lack of net earnings, no substantial intangible elements of value could reasonably be attributed to the railroad of that company. In order to justify the increases made, there would have to be attributed to these lines large amounts from system earnings. To sustain the addition for 1919, it is necessary to take enough to overcome the deficit of $4,741 per mile plus a fair return on the value of the physical property and on the $23,730 per mile fixed as a basis for additional taxes.

The draft on earnings from other parts of the system to sustain the increase for 1918 would not be so heavy. But it is equally obvious that there is no foundation for the finding that there existed in these lines intangible values of $1,730,090 or any other substantial amount in excess of the value fairly to be attributed to the physical elements of the railroad. If intangible elements were attributed to the system at the same rate per mile as results from the distribution of the added amount to the mileage of the Southern Railway in Kentucky, their value would be more than $200,000,000 for 1919 and more than $120,000,000 for 1918. Clearly there is no foundation for any such results. The mere statement of the figures is sufficient to show that the amount added as a basis for franchise taxes is so excessive and unreasonable that it cannot be sustained; and such an application of the system earnings amounts to an attempt to tax property outside the State. And as the direct earnings per mile of the lines of that company are so much less than the average for the system, it is plain that the amount adjudged to have been omitted was arbitrarily excessive and included values of system property beyond the limits of Kentucky.

Moreover, the percentages used to make the apportionment to Kentucky were too high. Reference to the figures for 1919 will be sufficient. There was taken 4.273 per cent of $432,326,444.12, the system value to be apportioned. The system mileage was 9939.1, and that used for the apportionment was 424.61. The Southern Railway Company in Kentucky had 127.63 miles, the Cincinnati, New Orleans and Texas Pacific, 197.5, the Mobile and Ohio, 38.693, the Cumberland Railroad, 12.9, and the Cumberland Railway, 1.74. As the court held that the lines of the three companies last mentioned were not so connected with the system that plaintiffs in error were liable in respect of them, their mileage was erroneously included in the factor used for apportionment to the lines taxed. And for the reasons stated the mileage of the Cincinnati, New Orleans and Texas Pacific

should not have been included. The mileage used to make the apportionment was more than three times that of the Southern Railway in Kentucky, and was more than thirty per cent. in excess of the combined mileage of that company and the Cincinnati, New Orleans and Texas Pacific. Obviously deduction of the lesser value of the Kentucky mileage on which the owners had paid taxes did not eliminate the error.

The enforcement of the franchise taxes so assessed would violate the due process clause of the Fourteenth Amendment.

The Commonwealth asserts that in the Kentucky courts the company did not make "the objection which is made here that this was a tax on property outside the State." But the record shows the contrary. The petition alleged that a portion of the Kentucky franchise had been omitted from assessment and prayed that such portion be assessed and taxed. The answer of plaintiffs in error not only denied liability and alleged that to hold the company liable and to attempt to add to that assessment would be a violation of the Fourteenth Amendment, but it also stated: "Defendants say that the effort made herein is simply for the purpose of endeavoring to bring into the State of Kentucky for purposes of taxation, property not in Kentucky, and values appertaining to property not in Kentucky, and earnings derived from property not in Kentucky; that to do this would be a violation of . . . the Constitution of the United States, particularly the Fourteenth Amendment thereof." In its first decision (193 Ky. 474), the Court of Appeals said (p. 488): "It is our conclusion, therefore, that the court should have assessed against defendant [Southern Railway Company of Virginia] Kentucky's portion of the intangible property assessed by the proportion of the mileage that the lines nominally operated by the 'Southern Railway Company in Kentucky' bear to the entire mileage of defendant's system estimated according to the method provided by the statute. But it is insisted that

this would result in taxing in Kentucky property having no situs here. . . ." Then follows the court's answer to that contention. This shows that the court distinctly recognized and passed upon the contention that the imposition of the additional franchise taxes would be to tax property outside Kentucky. That decision, according to the local rule, not only bound the lower court, but controlled the disposition of the case on the second appeal. *Hopkins* v. *Adam Roth Grocery Co.*, 105 Ky. 357, 358. The objections were reiterated in an amended answer filed after the first decision. And the Court of Appeals in its second decision declared that the additional assessments "were made in accordance with and are concluded by the former opinion herein." Clearly, the objections made in the state courts were sufficient. They went to the point that, as proposed to be applied and enforced, the state statutes would operate to tax property outside and beyond the jurisdiction of Kentucky in contravention of the Fourteenth Amendment. And, notwithstanding these objections, the Court of Appeals in its first decision directed the making of these additional assessments; and, in its second decision, declared that they had been made as directed and affirmed the judgment of the Circuit Court by which they were determined.

A petition for certiorari was filed, but, as the case is properly here on writ of error, the petition will be denied.

Judgment reversed on writ of error.
Petition for certiorari denied.

A true copy.

Test:

Clerk, Supreme Court, U. S.

Supreme Court of the United States

Nos. 33 and 34.—October Term, 1926.

Southern Ry. Co., Plaintiff in Error,
33 *vs.*
Commonwealth of Kentucky.

Andrew W. Mellon, Director General,
34 *vs.*
Commonwealth of Kentucky.

In Error to the Court of Appeals of Kentucky.

[April 11, 1927.]

Mr. Justice Brandeis, dissenting.

I do not consider the merits of this case, because, in my opinion, it should be affirmed on a point of practice which was urged here by the Commonwealth. On writ of error to a state court, even where, as here, this Court has jurisdiction, no objection is reviewable which was not made there. The question on which the judgment of the Court of Appeals of Kentucky is reversed was not raised or passed upon below.

The claim made below was that the Southern could not be taxed at all in Kentucky under the unit rule and that, therefore, the statute as applied was void. *Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U. S. 282, 288-290. The Commonwealth admitted that the Southern, a Virginia corporation, did not own the Kentucky lines directly. The Southern admitted that it controlled them by stock ownership. In support of the claim that the unit rule

could not be applied, the Southern made two contentions. The first was dealt with by the Court of Appeals in its first opinion, 193 Ky. 474; the second, in its second opinion, 204 Ky. 388. The first contention was that the unit rule could have no application, because the Southern was not doing business in Kentucky. That contention the Court of Appeals decided against the Southern for all the years; and this Court affirms the ruling. The second contention was that the unit rule did not apply, because there was not unity of use and operation of the Kentucky lines with its lines elsewhere. The question depended upon the amount of control exercised by the Southern Railway Company over the C., N. O. & T. P. Railway, which connected the Southern Railway in Kentucky with the rest of the Southern system. This contention the Court of Appeals decided in favor of the Southern for the years 1914, 1915 and 1916; but against it for the years 1917 and 1918. With this ruling also this Court agrees. The reversal by this Court is based on an entirely different claim. It is on the ground that the method of assessment used was such as to furnish, as a basis for the franchise tax, an amount so unreasonable and arbitrary as to involve taxation of property outside the State, in view (1) of the fact that the per mile earnings of the entire system were so much larger than the per mile earnings of the Southern in Kentucky, and (2) of the supposed use of too large a percentage intended to represent the proportion of the mileage in Kentucky to the total mileage of the system.

The Court of Appeals recognized clearly that it could not tax in Kentucky any property outside its limits. It upheld the tax as an increase of assessment upon property located confessedly in Kentucky, applying the rule of *Pullman Co.* v. *Richardson,* 261 U. S. 330, 338, that "if the property be part of a system and have an augmented value by reason of a connected operation of the whole, it may be taxed according to its value as part of the system, although the other parts be outside the State;—in other

words, the tax may be made to cover the enhanced value which comes to the property in the State through its organic relation to the system."

Applying the unit rule, however, there are two grounds on which a decision sustaining the claim that property outside the State has been taxed might have rested, if the appropriate claim had been made below. It might have been held that the statute, so far as it required the adoption of the mileage plan of valuation, was void as applied, because the different character of the lines outside Kentucky precluded the application of the per mile method as a basis of valuation. Compare *Fargo* v. *Hart*, 193 U. S. 490; *Wallace* v. *Hines*, 253 U. S. 66, 69. Or it might have been held that the tax was void, because the additional assessment based on mileage without the State was so arbitrary and unreasonable in amount as to violate due process. Compare *Union Tank Line Co.* v. *Wright*, 249 U. S. 275; *Wallace* v. *Hines*, 253 U. S. 66, 69-70. But neither of these claims was made in the court below. The only contentions made there were those which this Court and the lower court agree in holding unfounded—namely, that the Southern was not doing business in Kentucky and that there was no such unity of use and operation of the lines within and those without the State as to permit of the application of the unit rule.[1]

---

[1]The reason urged by the Southern in support of the second contention was, as the second opinion recites, that the Kentucky lines "had neither physical nor operative connection with lines outside of the state . . . and that to apply the notion of organic unity to all its lines under such circumstances is violative of the Fourteenth Amendment of the Constitution of the United States, in that it brings into Kentucky for taxation purposes values wholly outside the state. Whether or not this is true is the sole question presented for decision upon these appeals." The Court of Appeals decided the second contention in favor of the Southern for the years 1914, 1915 and 1916, because it concluded "that there was in fact no physical connection between the Northern branch and the Southern branch of the defendant's lines, and that despite the defendant's ownership and control of both of these separate branches, they cannot, under the many decisions of the Supreme Court of the United States, be considered as parts of a single system for the purpose of ascertaining the value of defendant's franchise employed in Kentucky without violating the Fourteenth Amendment of the federal Constitution." It held the Southern taxable for the years 1917 and 1918 because in 1917 the "defendant acquired the C. N. O. & T. P. Ry. Co.,

The second opinion of the Kentucky Court of Appeals recites that "it is admitted that the assessments for 1917 and 1918 were made in accordance with and are concluded by our former opinion." Hence it was necessary for the plaintiff-in-error to show that the objections insisted upon in this Court were raised upon the first trial or the appeal in the state court.[2] A consideration of the entire answer and of the entire first opinion make it altogether clear that the contention, which was advanced by the answer and refuted by the opinion, consisted solely of the claim that any assessment against the Southern would be unconstitutional as taxing property outside the State because the Southern was not doing business within the State. Neither the record nor the opinion of the Court of Appeals discloses that there was an objection to the assessment as such. Nowhere in the opinion is there any reference to the figures urged here as showing the arbitrariness of the statute as applied.

It cannot be said "that the necessary effect in law of a judgment, which is silent upon the question, is the denial of a claim or right which might have been involved therein, but which in fact was never in any way set up or spoken of." *Dewey* v. *Des Moines*, 173 U. S. 193, 200. The rule that a claim or right which was not asserted in the state court cannot be deemed to have been denied, and hence cannot be insisted upon in this Court has been long

---

and thus unified all of its holdings into a single unit of use and management." In considering the situation for the earlier years it stated: "The question for decision then finally narrows to whether for the purpose of valuing defendant's franchise employed in Kentucky, the line from Danville, Kentucky, to St. Louis, Mo., is to be considered as a separate unit or as a part of a system including also defendant's eastern and southern lines."

[2]As showing that they were raised, this Court relies upon the allegation of the answer that "the effort made herein is simply for the purpose of endeavoring to bring into the State of Kentucky for purposes of taxation, property not in Kentucky; . . . that to do this would be in violation of . . . the Fourteenth Amendment," and upon a quotation from the first opinion of the Kentucky Court of Appeals to the effect that "it is insisted that this would result in taxing in Kentucky property having no situs here. . . ." The reliance of this Court appears to rest upon a misapprehension. On the first trial, the lower courts dismissed the State's petition. As no method of assessment was before the Court of Appeals, it could not, in its first opinion, have passed upon the arbitrariness of this or any other method of assessment. See 193 Ky. 474, 489.

established.[3] It is true also that the party defeated upon a federal question in a state court will not be limited in this Court to the same arguments upon that question, *Dewey* v. *Des Moines, supra,* at p. 198; and that, if the federal question is properly raised, it is immaterial that the state court may have refused to discuss the point. *Erie R. R. Co.* v. *Purdy,* 185 U. S. 148, 154. But if the contention made below differs from the contention made here to such a degree that the decision upon one would not necessarily conclude the other, the raising of one below will not permit the raising of the other here, even if the same provision of the Constitution be the basis of both claims. Compare *Dewey* v. *Des Moines, supra; Marvin* v. *Trout,* 199 U. S. 212, 223-224, 227.

The importance of the rule of practice is illustrated by the case at bar.[4] Because the reasonableness of the method of assessment was not questioned below, there is nothing in the record to show what figures and what method of calculation were used by the taxing officers. The figures adopted by this Court are presented only in the brief of the plaintiff in error. They are protested by counsel for the Commonwealth. Moreover, there is reason to believe that the inferences drawn from them are unsound.

---

[3] In 1836 Mr. Justice Story, because of the fact "that a different impression exists at the bar," reviewed all the cases that had reached this Court from the state courts, finding that they exhibited "an uniformity of interpretation . . . which has never been broken in upon," requiring that, in order to give the Court jurisdiction, the question sought to be reviewed had both to be raised in the court below and there decided. Crowell v. Randell, 10 Pet. 368, 392, 398. By 1894 Chief Justice Fuller regarded such principles as "axiomatic." California Powder Works v. Davis, 151 U. S. 389, 393. The rule is still inflexible. New York v. Kleinert, 268 U. S. 646.

[4] Compare Hamilton Co. v. Massachusetts, 6 Wall. 632, 636; National Bank v. Commonwealth, 9 Wall. 353, 363; Edwards v. Elliott, 21 Wall. 532, 557; Wilson v. McNamee, 102 U. S. 572; Keokuk & Hamilton Bridge Co. v. Illinois, 175 U. S. 626, 633; Bolln v. Nebraska, 176 U. S. 83, 90; Chapin v. Fye, 179 U. S. 127; Capital City Dairy Co. v. Ohio, 183 U. S. 238, 248; Cox v. Texas, 202 U. S. 446, 452; Montana v. Rice, 204 U. S. 291, 301; Hunter v. Pittsburg, 207 U. S. 161, 180; Selover, Bates & Co. v. Walsh, 226 U. S. 112; Illinois Central R. R. Co. v. Mulberry Coal Co., 238 U. S. 275, 281; Bullen v. Wisconsin, 240 U. S. 625, 632; Hiawassee River P. Co. v. Power Co., 252 U. S. 341. Compare Virginian Ry. Co. v. Mullens, 271 U. S. 220.

FIGURES, METHOD AND CALCULATION USED IN MAKING ASSESSMENT THAT WAS REVERSED IN 274 U. S. 76 (R. ——) 271-274

YEAR ENDED JUNE 30, 1917, ON WHICH TAXES FOR THE YEAR 1918 WERE BASED.

Net railway operating income, Sou. Ry. Co., Va., and owned, operated, leased and controlled roads		$ 31,806,408.49
Net railway operating income, C. N. O. & T. P.		4,970,326.01
		$36,776,734.50
Capitalized at 7%		$525,381,921.43
DEDUCT: Total outside excess tangible values, *i. e.*, shops, terminals and double tracks, of Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	$67,832,331.71	
Total outside excess tangible values, *i. e.*, shops, terminals and double tracks, C. N. O. & T. P.	1,019,582.15	
		$68,851,913.86
DEDUCT total tangible outside value, we have		$456,530,007.57
Entire mileage Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	9,761.36	
Entire mileage, C. N. O. & T. P.	337.27	
	10,098.63	
Ky. mileage, Sou. Ry. Co., Ky., M. & O., Cumberland R. R., and Cumberland Ry.	227.14	
Ky. mileage C. N. O. & T. P.	197.50	
	424.64	
Proportion Ky. to total mileage 4.209%—4.209% of $456,530,007.57 gives total value in Ky		$19,215,348.02
Equalized at 75%		$14,411,511.02
Values heretofore paid on tangible and intangible property in Ky., by Sou. Ry. Co., Ky., M. & O., Cumberland R. R. and Cumberland Ry	$3,500,053.00	
Values heretofore paid on tangible and intangible property in Ky., by C. N. O. & T. P.	9,181,368.00	
		$12,681,421.00
Omitted value Southern Ry. Co., Va., franchise in Ky		$1,730,090.02

Reversed

FIGURES, METHOD AND CALCULATION USED IN MAKING ASSESSMENT ~~IN PRESENT JUDGMENT~~ (R. ——). 1 271-274)

YEAR ENDED DECEMBER 31, 1918, ON WHICH TAXES FOR THE YEAR 1919 WERE BASED.

Net railway operating income, Sou. Ry. Co., Va., and owned, operated, leased and controlled roads		$ 32,969,380.58
Net railway operating income, C. N. O. & T. P.		3,047,946.55
		$36,017,327.13
Capitalized at 7%		$514,533,244.71
DEDUCT: Total outside excess tangible values, *i. e.*, shops, terminals and double tracks of Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	$80,160,065.06	
Total outside excess tangible values, *i. e.*, shops, terminals, and double tracks of C. N. O. & T. P.	2,046,735.53	
		$82,206,800.59
DEDUCT total tangible outside values, we have		$432,326,444.12
Entire mileage Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	9,601.83	
Entire mileage C. N. O. & T. P.	337.27	
	9,939.10	
Ky. mileage Sou. Ry. Co., Ky., M. & O., Cumberland R. R., and Cumberland Ry.	227.11	
Ky. mileage C. N. O. & T. P.	197.50	
	424.61	
Proportion Ky. to total mileage 4.273%—4.273% of $432,326,444.12 gives total value in Ky.		$18,473,308.96
Equalized at 85%		$15,702,312.62
Values heretofore paid on tangible and intangible property in Ky. by Sou. Ry. Co., Ky., M. & O., Cumberland R. R. and Cumberland Ry.	$3,500,512.00	
Values heretofore paid on tangible and intangible property in Ky. by C. N. O. & T. P.	9,173,208.00	
		$12,673,720.00
Omitted value Southern Ry. Co., Va., franchise in Ky.		$3,028,592.62

Present

FIGURES, METHOD AND CALCULATION USED IN MAKING ASSESSMENT ~~THAT WAS REVERSED IN 274 U. S. 76~~ (STIPULATION R. ——). 1 280-284

YEAR ENDED JUNE 30, 1917, ON WHICH TAXES FOR THE YEAR 1918 WERE BASED.

Net railway operating income, Sou. Ry. Co., Va., and owned, operated, leased and controlled roads		$ 31,806,408.49
Net railway operating income, C. N. O. & T. P.		4,970,326.01
		$36,776,734.50
Capitalized at 7%		$525,381,921.43
DEDUCT: Total outside excess tangible values, *i. e.*, shops, terminals and double tracks, of Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	$67,832,331.71	
Total outside excess tangible values, *i. e.*, shops, terminals and double tracks, C. N. O. & T. P.	1,019,582.15	
		$68,851,913.86
DEDUCT total tangible outside value, we have		$456,530,007.57
Entire mileage Sou. Ry. Co., Va., and owned operated, leased and controlled roads	9,761.36	
Entire mileage, C. N. O. & T. P.	337.27	
	10,098.63	
Ky. mileage, Sou. Ry. Co., Ky., M. & O., Cumberland R. R., and Cumberland Ry	227.14	
Ky. mileage C. N. O. & T. P.	197.50	
	424.64	
Proportion Ky. to total mileage 4.209%—4.209% of $456,530,007.57 gives total value in Ky		$19,215,348.02
Equalized at 75%		$14,411,511.02
Values heretofore paid on tangible and intangible property in Ky., by Sou. Ry. Co., Ky., M. & O., Cumberland R. R. and Cumberland Ry	$3,500,053.00	
Values heretofore paid on tangible and intangible property in Ky., by C. N. O. & T. P.	9,181,368.00	
		$12,681,421.00
Omitted value Southern Ry. Co., Va., franchise in Ky		$1,730,090.02

FIGURES, METHOD AND CALCULATION USED IN MAKING ASSESSMENT IN PRESENT JUDGMENT (STIPULATION R. ——). 280-284

YEAR ENDED DECEMBER 31, 1918, ON WHICH TAXES FOR THE YEAR 1919 WERE BASED.

Net railway operating income, Sou. Ry. Co., Va., and owned, operated, leased and controlled roads		$ 32,969,380.58
Net railway operating income, C. N. O. & T. P.		3,047,946.55
		$36,017,327.13
Capitalized at 7%		$514,533,244.71
DEDUCT: Total outside excess tangible values, *i. e.*, shops, terminals and double tracks of Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	$80,160,065.06	
Total outside excess tangible values, *i. e.*, shops, terminals, and double tracks of C. N. O. & T. P.	2,046,735.53	
		$82,206,800.59
DEDUCT total tangible outside values, we have		$432,326,444.12
Entire mileage Sou. Ry. Co., Va., and owned, operated, leased and controlled roads	9,601.83	
Entire mileage C. N. O. & T. P.	337.27	
	9,939.10	
Ky. mileage Sou. Ry. Co., Ky., M. & O., Cumberland R. R., and Cumberland Ry.	227.11	
Ky. mileage C. N. O. & T. P.	197.50	
	424.61	
Proportion Ky. to total mileage 4.273%—4.273% of $432,326,444.12 gives total value in Ky.		$18,473,308.96
Equalized at 85%		$15,702,312.62
Values heretofore paid on tangible and intangible property in Ky. by Sou. Ry. Co., Ky., M. & O., Cumberland R. R. and Cumberland Ry.	$3,500,512.00	
Values heretofore paid on tangible and intangible property in Ky. by C. N. O. & T. P.	9,173,208.00	
		$12,673,720.00
Omitted value Southern Ry. Co., Va., franchise in Ky.		$3,028,592.62